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1964 REVENUE ACT--PROVISIONS OF SIGNIFICANCE TO FARMERS

A Guide For
Professional Workers
In Agriculture

Farm Production Economics Division
Economic Research Service
U. S. DEPARTMENT OF AGRICULTURE

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By Harvey Shapiro, Economist
Farm Production Economics Division
Economic Research Service

INTRODUCTION

The Revenue Act of 1964 was signed into law by the President on February 26, 1964. This marked the first major overhaul of the Federal Income Tax in a decade.

These changes will affect every taxpayer. Several provisions will particularly affect farmers' tax liabilities and their after-tax incomes. The general economic stimulation expected from these changes is also of considerable significance to farmers.

RATE REDUCTION

The Revenue Act of 1964 provides for a two-step reduction in tax rates from the present range of 20 to 91 percent to a range of 16 to 77 percent in 1964 and of 14 to 70 percent in 1965, and succeeding years. When fully effective in 1965, the reduction will mean an average rate decrease of more than 14 percent for all taxpayers. However, the 1965 reduction for the first $1,000 of taxable income--$2,000 for a married person--is about 27 percent. In 1961, two-thirds of U. S. farm families had taxable incomes of less than $2,000; therefore, this reduction, the highest in the program, will be of particular help to them.

A typical married couple with no dependents and a net income from farming of $3,000 a year, and using the standard deduction, paid $300 in taxes in 1963, but in 1965 they will pay only $200. Most of this 33 percent decrease will come from the reduction in rates.

A typical married couple with two dependents and a 1963 net income of $6,000 from farming paid $600 in taxes in that year. In 1965, they will pay only $450, a reduction of 25 percent. If the same couple has a net income of $10,000, their 1965 tax liability will be 19 percent lower than in 1963.

Tax rates for 1963 and the rates to be in effect for 1964 and 1965 are indicated in table 1.

The overall effect of the reduced rates will mean a tax reduction of $250 million to $300 million from the more than $1.3 billion paid by farmers under the old rates.

MINIMUM STANDARD DEDUCTION

The provision of a minimum standard deduction is as important to many farm taxpayers as the reduction in rates. Before enactment of the tax bill, taxpayers had the option of either itemizing personal deductions (interest, taxes, etc.) or using a standard deduction provided by the law. Taxpayers choosing the standard deduction could deduct 10 percent of their adjusted gross income--up to a maximum of $1,000. The smaller the taxpayer's income, the smaller the standard deduction.

Every taxpayer, no matter how small his income, can now choose between either the minimum standard deduction or a standard deduction of 10 percent of his adjusted gross income. The minimum standard deduction is $300 for a single taxpayer; $400 for a married couple filing jointly. An additional $100 deduction can be claimed for each dependent up to a maximum of $1,000. For example, a married couple with three children and an adjusted gross income of $2,000 can now deduct $700 ($400 plus $300 for their children's exemptions) instead of the 10 percent standard deduction of $200.

If this married couple had an adjusted gross income of $8,000, they could take the 10 percent deduction ($800) instead of the amount permitted under the new minimum. These deduction are in addition to the $600 personal exemption.

Table 1.--Individual income tax rate schedules

Taxable income bracket		1963 rate	1964 rate	1965 rate	1965 rate as a percentage of 1963 rate
Single person	Married (joint return)				
$1,000	$1,000	Percent	Percent	Percent	Percent
0-0.5	0-1	20	16.0	14	70)
0.5-1.0	1-2	20	16.5	15	75) 77.5
1.0-1.5	2-3	20	17.5	16	80)
1.5-2.0	3-4	20	18.0	17	85)
2-4	4-8	22	20.0	19	86
4-6	8-12	26	23.5	22	85
6-8	12-16	30	27.0	25	83
8-10	16-20	34	30.5	28	83
10-12	20-24	38	34.0	32	84
12-14	24-28	43	37.5	36	84
14-16	28-32	47	41.0	39	83
16-18	32-36	50	44.5	42	84
18-20	36-40	53	47.5	45	85
20-22	40-44	56	50.5	48	86
22-26	44-52	59	53.5	50	85
26-32	52-64	62	56.0	53	85
32-38	64-76	65	58.5	55	85
38-44	76-88	69	61.0	58	84
44-50	88-100	72	63.5	60	83
50-60	100-120	75	66.0	62	83
60-70	120-140	78	68.5	64	82
70-80	140-160	81	71.0	66	81
80-90	160-180	84	73.5	68	81
90-100	180-200	87	75.0	69	79
100-150	200-300	89	76.5	70	79
150-200	300-400	90	76.5	70	78
200-300	400-600	91	77.0	70	77
300-400	600-800	91	77.0	70	77
400 and over	800 and over	91	77.0	70	77

Taxpayers still retain the option of itemizing their deductions if their total exceeds the standard deductions described above.

Most of the benefits from the minimum standard deduction will go to families with incomes below $5, 000. The low income level of many farm families will make them prime beneficiaries of this change.

TAX BENEFITS TO THE AGED

Almost 10 percent of farm people--about 1.3 million persons--are 65 years old or older. Another 1.3 million will reach that age within 10 years. These older farm people receive additional tax benefits under the Revenue Act of 1964. These include: (a) A partial exclusion from taxation of the gain received from the sale of the taxpayer's personal residence; (b) an increased medical expense deduction; (c) an additional minimum standard deduction; and (d) special retirement income credit.

(a) Taxpayers 65 years of age and older can exclude part of the gain on the sale of their personal residence if the sales price exceeds $20, 000 and all of the gain if the sales price is less than $20, 000. The part excluded is computed by using the following equation:

$$\frac{\$20,000}{\text{Sales price}} \times \text{profit} = \text{amount excluded from taxable income.}$$

For example, a taxpayer (65 years old) sells his residence for $24, 000 at a $6,000 profit. Of this total gain, $5, 000 (20/24 times $6, 000) would be excluded from his adjusted gross income and only $1, 000 would be subject to taxation (at capital gains rates). If the sales price was $17, 000 with a $6, 000 profit, the entire $6, 000 would be excluded. The exclusion can be applied only once to the sale of residence after the taxpayer is 65 years old.

(b) Medicine and drug expenses were deductible only to the extent that they exceeded 1 percent of the taxpayer's adjusted gross income. This limitation has now been removed for all taxpayers over 65 years of age and for expenses paid on behalf of dependent parents 65 years old

or older. In short, payments for medicines and drugs for persons 65 and over are fully deductible from income for tax purposes.

(c) Taxpayers who are 65 or over--or who are blind--are allowed an additional $100 on their minimum standard deduction. This is in addition to the additional $600 personal exemption such taxpayers have been receiving.

(d) The new law liberalizes the special tax credit granted to retired couples against dividends and other kinds of retirement income on joint returns. The law now provides that where the husband and wife have both reached age 65 before the close of the year, the maximum income on which the credit may be based is $2,286 as contrasted with $1,524 under the old law. The credit will be reduced from 20 percent to 17 percent of eligible income for 1964 and 15 percent for 1965.

AVERAGING OF INCOME

Returns from farming often vary greatly from year to year, depending on the vagaries of the weather, changes in farm prices, and other factors. In some farming areas, it is not unusual for a farm to produce relatively little income for several consecutive years, and then make it up in 1 favorable year. Farmers in these areas must depend upon their earnings in good years to carry them through bad years. Heretofore, the revenue laws, by taxing income received in the occasional highly profitable years at high rates, in effect penalized individuals with such fluctuating incomes. The new law, however, contains an income averaging provision which will benefit individuals with large fluctuations in income. This provision extends the current practice of permitting taxpayers to reduce the amount of income subject to taxation by carrying back current net operating losses for 3 years and, if not fully absorbed, carrying them forward for 5 years.

The tax saving resulting from averaging depends upon the amount a taxpayer's income varies and the size of his income. The averaging provision applies to that income

received in any year that exceeds by more than one-third the average income of the previous 4 years. The provision does not apply unless at least $3, 000 is to be averaged; in cases involving only a moderate fluctuation in income, averaging relief is not very important. For farmers who have relatively high income and whose income varies widely from year to year, however, the benefits under the new averaging provision will be substantial.

For example, a farmer having a taxable income of $20, 000 in 1965 would pay a tax (at 1965 rates) of $4, 380. If his taxable income had averaged $6, 000 for the preceding 4 years he could, by using the new averaging provisions, reduce his tax to $4, 020, a saving of $360.

INVESTMENT CREDIT

The 7 percent investment credit, enacted in 1962, has been modified somewhat by the Revenue Act of 1964. The investment credit, as originally enacted, allowed the purchaser of new equipment to take 7 percent of its cost as a credit against his tax liability. However, the taxpayer was also required to subtract the amount of the credit from the cost of the asset in order to determine the tax deductible depreciation.

For example, a farmer buying $1,000 of qualified equipment (tangible personal property purchased after December 31, 1961) having a useful life of at least 8 years could deduct $70 from his tax bill in the year he acquired the new equipment. However, he would have to deduct $70 from the depreciation basis, making it $930. The deduction would be $23 for equipment with an expected useful life of 4 to 6 years; it would be $47 with an expected useful life of 6 to 8 years. Property with an expected life of less than 4 years does not qualify for the investment credit.

The new law provides that the depreciation base for eligible property placed in service after December 31, 1963, will not be reduced by the amount of the credit. In the example cited above, the depreciation base would be $1,000.

The result of this change will be to reduce the farmer's tax liabilities somewhat and to increase the rate of return on his investment.

CROP INSURANCE PROCEEDS

Taxpayers on a cash basis of accounting may now elect to include insurance proceeds received as a result of destruction or damage to crops in income for the year following the destruction or damage. However, they must establish that income from these crops would not have been reported in the year in which they were raised.

BEARING ON STATE AND LOCAL REVENUE

Total State and local taxes doubled in the decade from 1952 to 1961 and have been increasing at an average rate of 7 percent per year. Farmers have borne a share of these increases. For example, farm real estate taxes rose to $1,327 million in 1961 from $777 million a decade earlier. Thus, farmers have a direct interest in any measure that affects State-local revenues.

The Treasury has estimated that when the tax cut is fully in effect in 1965, it will generate a large increase in total national output. The increase in economic activity is expected to add about $1.5 billion a year to total State tax revenues and approximately $1.4 billion to local tax revenues. This increase in State-local revenues, arising without an increase in rates or new taxes, will relieve financial pressures somewhat on these governments.

MISCELLANEOUS

The new law also contains several other changes which may also be of interest to farmers. These changes slightly modify the tax treatment accorded to (a) capital gains, (b) deduction of charitable contributions, (c) the deduction of certain State and local taxes, (d) the deduction of casualty and theft losses, and (e) the dividend credit and exclusion.

(a) Capital gains: Heretofore, individuals were permitted to offset capital losses only against capital gains plus up to $1,000 of ordinary income. Capital losses exceeding the sum of these two items could be carried over for 5 years and used to reduce income. The new law dropped the 5-year limitation on carrying over capital losses of individuals.

Certain capital gains changes, as originally proposed, were not enacted into law. These were (1) to extend the holding period from 6 months to 1 year, (2) imposition of a capital gains tax on assets transferred at death, (3) the redefinition of capital gains provisions regarding livestock, and (4) a reduction in the rates applicable to capital gains.

(b) Charitable contributions: The old law allowed taxpayers to claim deduction of as much as 20 percent of their income for gifts to charities and private foundations. An additional 10 percent had been allowed for gifts to churches and schools. Now, taxpayers can deduct up to 30 percent of their income for contributions to all publicly controlled foundations and charitable organizations. There is still a 20 percent limit on gifts to private foundations.

The new law also permits individuals to carry over charitable contributions exceeding the 30 percent annual limit for 5 years.

(c) State and local taxes: Under the new law, the following items are no longer deductible on Federal Income Tax returns: State and local taxes on liquor, cigarets, hotel rooms, and theater tickets, local drivers' licenses and auto tag fees.

(d) Casualty and theft losses: The new law has changed the provision covering the deduction of personal casualty and theft losses for income tax purposes. Heretofore, these losses were fully deductible by taxpayers who itemized their personal deductions. Now, taxpayers may deduct these personal losses only to the extent that the loss resulting from each casualty or theft exceeds $100.

This provision does not apply to business losses, which are still fully deductible.

(e) Dividend credit and exclusion: The 4 percent tax credit for dividends received will be reduced to 2 percent in 1964 and dropped entirely in 1965. The amount of dividends excluded from taxable income has been increased from $50 to $100, starting in 1964.

BENEFITS FROM GENERAL ECONOMIC STIMULATION

In addition to these specific benefits, significant benefits to agriculture are expected to result from the general economic stimulation induced by the tax changes. Farm youth will likely find greater opportunities for nonfarm employment and nonfarm job opportunities should be enhanced for farmers seeking supplementary income.

Employment in farming declined more than 3 percent a year during the decade of the 1950's and continues to decline. Each year, a large number of farm people, many of them youths just entering the labor market, are forced to seek nonfarm employment. At present, only about 1 out of 10 farm youths can expect to make his living as his father did. At existing levels of unemployment, many farm youths have difficulty finding nonfarm jobs.

For those remaining on the farm, opportunities to find part-time jobs to supplement farm income should be enhanced. The importance of nonfarm jobs is indicated by the fact that in recent years about 35 percent of farm operators' total personal incomes have come from nonfarm sources.

In summary, farmers will benefit from the Revenue Act of 1964 by having their taxes reduced, and by the increased economic opportunities that will result from the general economic stimulation provided by this law.

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